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In The Supreme Court of the United States

CENTRAL VIRGINIA COMMUNITY COLLEGE,
VIRGINIA MILITARY INSTITUTE,
NEW RIVER COMMUNITY COLLEGE, and
BLUE RIDGE COMMUNITY COLLEGE,

Petitioners,

v.

BERNARD KATZ, Liquidating Supervisor of the Bankruptcy Estate in *In re Wallace's Bookstores, Inc.*,

Respondent.

On Petition For A Writ Of *Certiorari*
To The United States Court Of Appeals
For The Sixth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Eleventh Amendment allows a State to bar an adversary proceeding brought against the State in bankruptcy court to avoid preferential transfers and to recover money owed to the debtor.

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STATEMENT OF THE CASE

Before it filed for bankruptcy under Chapter 11 in February 2001, Wallace's Bookstores, Inc. ("Wallace's") operated a nationwide chain of college bookstores. Wallace's business included relationships with the Petitioners, four Virginia colleges organized and funded by the Commonwealth.

After the bankruptcy proceeding began, the Respondent Bernard Katz, the liquidating supervisor of the bankruptcy estate, commenced adversary proceedings against each of the Petitioners. In those proceedings, Mr. Katz alleged claims under 11 U.S.C. §§ 547 and 550 to avoid and recover "preferential transfers," which occurred shortly before Wallace's filed for bankruptcy, and claims under § 542 and state law to collect money owed to Wallace's by the Petitioners. The complaints also sought orders under 11 U.S.C. § 502(d) disallowing claims by each Petitioner filed against the bankrupt estate, unless that Petitioner paid the money it owed to the estate. Two of the four complaints also sought to avoid and recover preferential transfers under Kentucky law.

Prior to the adversary proceeding being filed against it, Petitioner Virginia Military Institute ("VMI") filed a proof of claim in Wallace's Chapter 11 bankruptcy case.

Petitioners jointly moved to dismiss the four complaints on the ground that the actions were barred by sovereign immunity. Relying on *Hood v. Tennessee Student Assistance Corp.*, 319 F.3d 755 (6th Cir. 2003), which held that Congress has authority to abrogate sovereign immunity under the "Bankruptcy Clause" of Article I of the U.S. Constitution, the United States Bankruptcy Court for the Eastern District of Kentucky denied the motion. The

Petitioners appealed to the district court, which affirmed the bankruptcy court's decision.

The Virginia institutions then appealed to the United States Court of Appeals for the Sixth Circuit. While the appeal was pending, this Court issued its decision in *Tennessee Student Assistance Corp. v. Hood*, 124 S. Ct. 1905 (2004). In *Hood*, the debtor, in the course of her Chapter 7 bankruptcy, had sought discharge of student loans held by the Tennessee Student Assistance Corporation, a state entity. The question originally presented in that case was the same question presented by the Virginia Petitioners here: whether the Bankruptcy Clause grants Congress authority to abrogate state sovereign immunity from private suits. *Id.* However, while the Court discussed considerations pertinent to resolution of the sovereign immunity question, it did not decide that issue. Rather, it held that the discharge proceeding was an *in rem* action that did not implicate sovereign immunity. *Id.* at 1912-13.

Three months after this Court issued the decision in *Hood*, the Sixth Circuit decided the instant case, affirming the district court's decision in an unpublished *per curiam* opinion. (Pet. App. 1).

REASONS FOR DENYING THE WRIT

A. Petitioners Have Waived Sovereign Immunity In This Case.

A state's filing of a proof of claim in a bankruptcy case operates as a waiver of sovereign immunity for claims asserted against the state. *See Gardner v. New Jersey*, 329 U.S. 565, 573-74 (1947); *Arecibo Community Health Care, Inc. v. Puerto Rico*, 270 F.3d 17, 28 (1st Cir. 2001); *In re Lazar*, 237 F.3d 967, 978 (9th Cir. 2001); *In re Straight*, 143 F.3d 1387, 1392 (10th Cir. 1998). VMI filed a proof of claim in Wallace's Chapter 11 case prior to Katz's institution of the adversary complaints against the Petitioners. Accordingly, Virginia's claim to sovereign immunity, and thus the claim of each petitioner, has been waived.

In the present case, the Petitioners' assertion of sovereign immunity derives from their status as "arms of the state" of Virginia. The Petitioners assert that the immunity enjoyed by the Commonwealth of Virginia extends to them because, among other things, the state treasury will ultimately be responsible for paying any judgment against them. Moreover, the state Attorney General's Office acts as their legal counsel; they are designated by statute as "governmental instrumentalities," Va. Code Ann. § 23-14; *see also* Va. Code Ann. § 23-215 (referring to Virginia Community College System as a "state agency"); and each is subject to the oversight of the State Council on Higher Education, Va. Code Ann. §§ 23-9.3, 23-9.5, 23-9.6:1, 23-9.9. *See DeBauche v. Virginia Commonwealth Univ.*, 7 F. Supp. 2d 718, 722 & n.4 (E.D. Va. 1998). As an arm of the state, each of the institutions is "considered the Commonwealth of Virginia for purposes of sovereign immunity." (Pet. at ii, n.1). In one of the cases cited by the Petitioners on this point, the court explained that the University of Virginia could advance Eleventh Amendment immunity "as if [it] were Virginia itself," and thus the opinion used the name of the university "interchangeably" with the name "Virginia." *University of Va. v. Robertson*, 243 B.R. 657, 661 n.4 (W.D. Va. 2000).

Thus, VMI's claim to sovereign immunity actually belongs to the Commonwealth of Virginia. An act resulting in the waiver of sovereign immunity by a state entity

operates as a waiver with regard to the state itself. When VMI filed its proof of claim, its act operated as a waiver of Virginia's sovereign immunity, thereby constituting a waiver on behalf of Virginia's other state agencies. In *In re Charter Oak Associates*, 361 F.3d 760 (2d Cir. 2004), the Second Circuit recognized the full implication of a state entity's claim to sovereign immunity and its waiver of that immunity. The Second Circuit held that, when one Connecticut agency filed a proof of claim in a bankruptcy proceeding, it waived Eleventh Amendment immunity for other Connecticut agencies as well. In essence, any sovereign immunity enjoyed by the state of Connecticut was waived when its agency filed a proof of claim. *Id.* at 768. In reaching its holding, the Second Circuit placed great weight on the fact that any recovery by a Connecticut state agency redounds to the benefit of the Connecticut state treasury. *Id.* at 772. Connecticut law further provided that one state agency can offset an individual's debt to it against amounts owed by other state agencies to that individual. *Id.* The Virginia Code codifies a similar procedure. *See* Va. Code Ann. §§ 2.2-4801, 2.2-4806.

Virginia cannot have it both ways. It cannot file a claim in bankruptcy court, thereby seeking to gain the benefits provided to creditors under the Bankruptcy Code, yet still invoke sovereign immunity as a shield to the underlying adversary proceedings. Virginia's sovereign immunity in this bankruptcy case has been waived, and the Petitioners therefore have no basis to assert it. Thus, this case does not present the question on which Petitioners seek *certiorari*. Whether Congress can abrogate Virginia's immunity is not at issue because that immunity has been waived here.

B. The Lower Courts Should Be Given The Opportunity To Consider This Court's Recent Decision In *Hood*.

Just last May, this Court decided *Hood*, a case in which the petition presented the very same question that Petitioners seek to present here. The Court did not decide that question. But its decision on the alternative ground that the bankruptcy court's exercise of *in rem* jurisdiction to discharge a debt does not implicate the Eleventh Amendment offers new guidance to lower courts in bankruptcy proceedings involving a state entity by highlighting the circumstances in which bankruptcy claims do not implicate Eleventh Amendment concerns.

Aside from the Sixth Circuit, only one court has considered the ramifications of *Hood* on adversary proceedings brought against a state to avoid a preferential transfer. *See In re 360networks (USA), Inc.*, 316 B.R 797 (Bankr. S.D.N.Y. 2004). That court concluded that "a court's jurisdiction over preferential transfers arises from its exclusive jurisdiction over the property of the debtor," and, accordingly, actions to avoid preferential transfers are within the court's *in rem* jurisdiction. *Id.* at 803. Thus, under *Hood*, such actions do not implicate state sovereign immunity. The court in *In re 360networks* further held that a bankruptcy court may lack jurisdiction to order a state to return money to the debtor, but that a court could grant partial relief under 11 U.S.C. § 502(d), which requires a court to disallow claims of an entity that has received a preferential transfer. *Id.* at 805.

Relying on pre-*Hood* cases, the Petitioners describe a circuit split based on cases from five circuits. (Pet. at 7).

Yet none of the circuits have addressed the issue presented here in the year since *Hood*.[1] And at least two of the cases cited by the Petitioners are directly counter to *Hood*. *See Mitchell v. Franchise Tax Bd.*, 209 F.3d 1111 (9th Cir. 2000) (state immune from proceeding to discharge a debt); *Department of Transp. & Dev. v. PNL Asset Management Co.*, 123 F.3d 241 (5th Cir. 1997) (state immune from proceeding to resolve title to property).[2] Additional time is therefore necessary to allow the lower courts to apply *Hood* before this Court takes up the issue for a second time.

C. The Decision Below Is Correct.

In *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), the Court presented a two-part test for determining whether Congress had abrogated state sovereign immunity in a constitutionally permissible manner. First, the Court asked whether "Congress has unequivocally expresse[d] its intent to abrogate the immunity." *Id.* at 55 (citation omitted). In the present case, Congress made its intention to abrogate sovereign immunity unmistakably clear in the Bankruptcy Code. *See* 11 U.S.C. § 106(a) ("sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section . . .").

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[1] In a recent post-*Hood* case, the Ninth Circuit assumed that the state had Eleventh Amendment immunity from suit in the bankruptcy proceeding, but it did not analyze or decide the issue. *In re Pegasus Gold Corp.*, 2005 WL 53427 (9th Cir. 2005).

[2] Another of the cases on which Petitioners rely arose in a factual scenario far afield from the adversary proceedings in this case. *E.g.*, *Nelson v. La Crosse Cty. Dist. Attorney*, 301 F.3d 820 (7th Cir. 2002) (debtor sought injunction to block state from commencing criminal prosecution for restitution of money she allegedly embezzled).

Second, this Court in *Seminole Tribe* looked to whether Congress's attempt to abrogate state sovereign immunity was "pursuant to a valid exercise of power." 517 U.S. at 55 (citation omitted). Article I, section 8 of the United States Constitution grants to Congress authority "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." The determination whether the Eleventh Amendment diminished that authority turns on the structure of the original Constitution. As this Court has stated, "immunity from suit is a fundamental aspect of the sovereignty which the States enjoyed before the ratification of the Constitution, and which they retain today . . . except as altered by the plan of the Convention or certain constitutional amendments." *Alden v. Maine*, 527 U.S. 706, 713 (1999). The Eleventh Amendment did not alter the purposes of the Constitutional Convention and was intended only "to restore, not change, the structure established at the Convention that was apparently distorted by the" decision in *Chisholm v. Georgia*, 2 U.S. (2 Dall.) 419 (1793). 527 U.S. at 722-23.

In the Sixth Circuit's decision in *Hood*, the court analyzed the extent to which the Convention considered whether federal control over bankruptcy was a necessity. *Hood*, 319 F.3d at 763-65. After lengthy discussion, the Sixth Circuit concluded that the states' immunity was altered by the plan of the Convention, that the states had ceded their sovereignty at that time with regard to bankruptcy, and that Congress thus had the power to abrogate state sovereign immunity under its authority to make laws respecting bankruptcy. *Id.* at 767. This conclusion recognized both the Framers' intent to provide consistency in the treatment of debtors, which had varied greatly under the application of disparate state insolvency laws,

and their concern that individual states not be able to defeat the purposes fostered by bankruptcy relief. *Id.* 764-65.

Although some circuit courts have held otherwise, none of them undertook the "meticulous[] research" and careful analysis of *Hood*, instead offering only a "mechanical application of *Seminole Tribe*" without regard to the distinct language of the Bankruptcy Clause and the Framers' intent when empowering Congress with authority over bankruptcy. *Flores v. Illinois Dept. of Public Health*, 300 B.R. 599, 603 & n.4 (Bankr. D. Vt. 2003). Based on its careful analysis and consideration of the Framers' intent, the Sixth Circuit reached the correct result.

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be denied.

Respectfully submitted,

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